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DEPARTMENT FOR EUR/ERA, EUR/SCE AND EEB/ESC, COMMERCE FOR
TDA DAN STEIN

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SUBJECT: CROATIAN NATURAL GAS PROJECTS: LOOKING FOR NEW
MOMENTUM IN THE AFTERMATH OF THE CRISIS

¶1. Summary: The recent gas crisis has fueled discussion and interest in the subject of Croatian energy security and energy diversification. The most significant project addressing these issues is the long-delayed construction of an LNG terminal on the Adriatic. Senior government leaders have expressed confidence that the structure of the consortium will soon be finalized and that Croatia can move to the next step. However, senior executives from the three companies involved in the Croatian portion of the project, HEP, Plinacro, and INA, seem uninformed and give conflicting opinions about the true state of play and the reasons for the continuing delays in getting the project off the ground. Croatia plans a number of other projects which are also important, but whose impact on the broader theme of energy security will be more modest. Even if all planned projects are realized, Croatia will continue to rely on significant quantities of Russian gas for the foreseeable future. End Summary.

¶2. The Russia-Ukraine gas crisis has sparked increased interest in new energy diversification strategies, all of which are necessary, and none of which will free Croatia from the need for significant future quantities of Russian gas. Croatia avoided some of the more serious hardships experienced by its neighbors during the gas crisis since it has domestic production fulfilling roughly 60 percent of its demand. Nevertheless, Croatia could ill afford the slowdown in industrial output caused by the crisis and there is broader public interest now in exploring options for diversification of energy supply. These strategies include: 1) Moving forward with plans for an LNG terminal on the Adriatic; 2) Construction of a pipeline interconnector to Hungary; 3) Construction of a second underground storage facility; 4) Negotiation of new supplies from Algeria via Italy; and 5) Construction of a pipeline through Lika and Dalmatia to connect with the Ionian-Adriatic pipeline (IAP) from Albania.

LNG Terminal Update

¶3. In a meeting on February 6, Deputy Prime Minister Polancec told the ambassador and econoff that Croatia is committed now more than ever to pushing through with plans for an LNG terminal at Omisalj on the island of Krk. Although the LNG terminal has been under discussion for years, he told us Croatia was very close to finalizing the structure of Croatia's 25 percent share in Adria LNG, the international consortium spearheading the project. He said discussions had partially been held up by uncertainties in the privatization of the national oil company INA, and what role, if any, its new owners in Hungarian MOL would want to play in the project. The DPM said MOL was currently negotiating a participation in Adria LNG independent of the

Croatian consortium. Having just successfully negotiated the split of the gas trading business out of the INA/MOL deal, the way should be clear to finally determine the role of the other two partners in Croatia LNG: HEP (electric power monopoly), and Plinacro (gas transmission company). He anticipates the deal will be finalized and ready to move forward by the end of March.

14. (SBU) Others are more skeptical that the LNG terminal is finally ready to move forward. A senior manager and board member at Plinacro told us that the delay determining the structure of the new management at INA/MOL could not in itself account for the inability to launch the Croatian LNG consortium. It was also unclear to him what interest MOL could have in the LNG terminal, especially after MOL acquiesced to the government splitting out the gas trading business from INA. He sees unidentified strong interests behind the scenes trying to slow the project down, even suggesting undue influence of Gazprom over MOL management was to blame. Comment: These theories could prove to be unfounded if Minister Polancec's prediction is true and the Croatian consortium is finalized soon. We also spoke to a key board member at HEP who was completely unaware of the state of play with the Croatian consortium - strange considering HEP is one of the key players.

Pipeline Interconnector to Hungary

15. Plinacro's plan for a pipeline interconnector from Slavonski Brod to Varosfold in Hungary offers Croatia a distinct advantage in future supply options, as both the Nabucco and South Stream projects envision transit of

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Varosfold. It also would significantly shorten the route of Russian gas to Croatia, which currently is imported through Slovenia. Plinacro hopes to begin construction of this interconnector this year.

16. Several high level EU officials recently promised financial assistance to this project, part of a larger number of projects under consideration in the wake of the gas crisis. However, in a surprise announcement at the end of January, EU energy spokesperson Ferrand Tarradellas said the EU had decided not to fund the project because of Croatia's "insufficient preparation." Plinacro told us they were incensed at this judgment of a worthwhile project, and felt they had been discriminated against in favor of full EU member projects such as the TARP project linking Greece and Italy. Nevertheless, Plinacro claims the EU funds are not needed for the project to go forward as planned.

Underground Storage

17. Plinacro plans to construct a second underground storage facility at Okoli, south of Zagreb. Croatia currently has only one underground natural gas storage facility. Despite the renewal of gas imports from Russia, the reserve is still 50 percent depleted, according to an INA executive. He said another crisis would instantly put Croatia back in a dangerous situation. This storage facility has already been transferred to Plinacro in connection with the sale of INA to MOL and the separation from the deal of gas assets considered by the government to be strategic.

New Supplies from Algeria

18. Croatia began negotiations with Algeria during the gas crisis for additional supplies for delivery to Italy. Italy, in turn, would free up additional gas for Croatia from its Adriatic fields. A senior INA official has told us that negotiations are ongoing, but was unwilling or unable to give us details on when they might be completed.

Linking up Dalmatia

¶9. There is currently no gas distribution network in the southern half of Croatia along the coast to Dalmatia. Power generation in the region is largely hydropower, but Plinacro has ambitious plans for a 75-bar gas network to stretch the length of Croatia's coast, with interconnectors to the major urban areas. They hope to then link up with the projected Ionian Adriatic Pipeline from Albania, which would give access to future supplies crossing Turkey and Greece.

Comment

¶10. The gas crisis may well have the long term benefit of finally moving some of these projects out of the planning phase and into reality, particularly LNG. But even now, it is strange that conversations with senior managers at HEP, Plinacro and INA still reveal a great deal of confusion over what the Croatian consortium will look like, when it will be finalized, and the reasons for the continuing delays. The Deputy Prime Minister seemed genuine in his desire to get the project off the ground and his confidence that it would happen soon. Whenever it is ready to move to the next stage, the LNG project faces the problem of finding sufficient gas supplies for the facility. Supplies from the Middle East, especially Qatar, are reportedly fully contracted for the foreseeable future. When we raised this concern with the Plinacro executive, he pointed to four unspecified LNG terminals in the U.S. that had sat idle for years owing to lack of supply, but now were operating at full tilt and with solid profits. This did not seem to be a very convincing way to dismiss investor concerns over gas supplies for the new terminal.

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